Chapter 5

Developing intermediaries in a social capital market

5.1 A prominent theme over the course of this inquiry has been the importance of intermediaries in the development of a capital market for social economy organisations.[1] There is a need to support and encourage the emergence of intermediary organisations in the sector, as they have the potential to provide much of the enabling structures which will allow market development to occur.

5.2 The joint submission from the Department of Education, Employment and Workplace Relations and the Department of the Prime Minister and Cabinet (the departments' submission) commended the work of intermediaries across a number of spheres within the sector:

> Specialist social economy intermediaries are emerging around the world to support the growth of social enterprises, aggregating and matching finance, developing innovative financial products, promoting the development of capabilities and skills, providing physical and virtual collaboration spaces, improving technologies and providing networks. Intermediaries also play a valuable role in education and advice necessary to inform legal and business structures to support investment and appropriate types of investment for an organisation and its stage of growth and sources of capital.[2]

5.3 This chapter focuses on the role of intermediaries in the sector, looking at the roles that can be fulfilled by intermediary organisations in developing a social capital market, the types of intermediary organisations that can play these roles, and suggestions from submitters on how intermediaries can be supported and encouraged in Australia.

The role of intermediaries

5.4 The committee has heard that intermediary organisations can play a variety of roles in supporting the social economy and promoting the development of a social capital market, including:

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1 Centre for Social Impact, *Submission 27*, pp 5, 7–8; Foresters Community Finance, 'Financing Social Enterprise: Understanding Needs and Realities', *Submission 4–attachment 3* and *Supplementary Submission*, p. 1; JBWere, *Submission 19*, pp 6-10; Social Ventures Australia, *Submission 2*, p. 3; Social Finance Ltd, *Submission 16*; Ms Kylie Charlton, opening statement tabled at a public hearing in Canberra on 26 September 2011, p. 2; Mr David Thompson, National Roundtable of Nonprofit Organisations, *Committee Hansard*, 9 September 2011, p. 16.

2 Department of Education, Employment and Workplace Relations (DEEWR) and the Department of the Prime Minister and Cabinet (PM&C), *Submission 9*, p. 32.

- linking suppliers of capital with appropriate investment opportunities;
- helping organisations become 'investment ready' by providing services, advice and training to social economy organisations;
- contributing to the education and research base for the sector;
- developing new measurement frameworks and tools; and
- investing in innovation in the sector.[3]

5.5 The presence of intermediary organisations is lacking in Australia, reflecting the early stages of capital market development for social economy organisations and social impact investments.[4] Mr Michael Traill from Social Ventures Australia (SVA) commented:

> ... If you go to the UK you will see there is a diverse, eclectic, interesting, sophisticated, intermediary market. It is very limited in Australia. You have obviously done your homework. You are talking to all the known suspects in Australia. It is not a big group. And that is a real pity.[5]

Types of intermediary organisations

5.6 A 2011 research paper from the Young Foundation and the National Endowment for Science, Technology and the Arts in the UK classified social venture intermediary organisations into five basic categories:

- financial intermediaries;
- people, network and expertise;
- monitoring;
- marketing and distribution; and
- innovation.[6]

5.7 The role of each of these types of intermediaries, and their relevance in the Australian context, is discussed below.

Financial intermediary organisations

5.8 Financial intermediaries are seen as crucially important to the development of a capital market for social economy organisations.[7] Financial intermediary

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3 DEEWR and PM&C, *Submission 9*, pp 32–33.

4 Productivity Commission, *Contribution of the Not-for-Profit Sector*, pp 185, 234; Centre for Social Impact, *Submission 27*, p. 7.

5 Social Ventures Australia, *Committee Hansard*, 1 August 2011, p. 24.

6 As cited by DEEWR and PM&C, *Submission 9*, p. 32.

organisations have been described as 'organisations that link investors and social organisations, bringing sources of finance to social ventures and packaging investments into structured financial products that deliver a mix of social and financial returns'.[8] Financial intermediaries have the potential to offer a host of financial products and solutions to social economy organisations to move the sector away from a sole dependence on grant capital.

5.9 Some financial intermediaries operate essentially as niche banks, providing banking services and loan capital directly to organisations based on their expert knowledge of the sector. Some intermediaries manage social investment funds or act as a broker for social economy organisations and investors to mediate the creation of social investment 'deals'. Financial intermediaries also work with social organisations to build capacity and help them become investment ready.

5.10 The departments' submission commented on the lack of financial intermediaries providing capital to social economy organisations in Australia at the present time:

> There are relatively few financial intermediaries in Australia which specialise in providing community development finance; an overview was provided by the Productivity Commission. The Responsible Investment Association of Australasia and New Zealand identified 11 community finance providers in Australia in 2010 with total assets of $1,331 million, an increase of 15% on last year’s adjusted figure of $1,157 million. There is a more mature international market of such organisations. Examples include Charity Bank (UK), Triodos Bank (NE) with operations in a range of countries, Venturesome (UK) and Vancity Credit Cooperative (Canada).[9]

5.11 The Productivity Commission (PC) report also noted the role of these organisations, and argued that financial intermediaries such as Community Development Financial Institutions (CDFIs) are a crucial source of capital for the NFP sector in Australia. The report recommended the government explore options to encourage the financial intermediaries sector to offer appropriate products and services to the NFP sector.[10]

Linking suppliers of capital with investment opportunities

5.12 Financial intermediaries can play a key role in linking investors to investment opportunities. Working with both social economy organisations and investors,

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7 Productivity Commission, *Contribution of the Not-for-Profit Sector*, pp 185–191; Mr Michael Traill, Chief Executive Officer, Social Ventures Australia, *Committee Hansard*, 1 August 2011, p. 20.

8 DEEWR and PM&C, *Submission 9*, p. xix.

9 DEEWR and PM&C, *Submission 9*, pp 32–33.

10 Productivity Commission, *Contribution of the Not-for-Profit Sector*, pp 189–190, 194.

intermediary organisations can act as brokers between the two sectors. As Christopher Thorn, the Executive Director of Philanthropic Services at JBWere, explained:

> ...intermediaries are required, if you like, to educate the market and bring both the providers and the suppliers of the capital together to have those conversations. If they fully appreciate and understand the issues on both sides, they can then look to build appropriate opportunities whether they be initially discussions leading through to investment opportunities or executing transactions. As we pointed out in the submission, there is nothing unusual about that. In the history of capital markets over time the role of the intermediary to do that has been quite fundamental.[11]

5.13 Intermediaries have an emerging role working with social economy sector organisations to build capacity and help them to develop investment products that are more likely to attract investors. At the same time, they liaise with potential investors to help match them to suitable investment opportunities. At present there are few intermediaries playing this role in Australia. Notable examples include Foresters Community Finance, SVA and JBWere's Philanthropic Services division.

5.14 Mr Toby Hall, Chief Executive Officer of Mission Australia, told the committee that accessing intermediaries with expert knowledge of investment and financial markets is vital to creating viable investment propositions for the sector.[12] Mr Traill from SVA noted that the GoodStart deal (see paragraph 2.25) would not have been possible without the help of intermediaries which had access to a network of potential investors to provide capital:

> Finally, and this has come up again and again in the submissions that we have seen, we believe the role of intermediaries in this is vital. You can put us saying that down to naked self-interest, but we can say with some confidence and authority that you have to go to intermediaries who know how to access capital, particularly at the early stages of this market. Markets are built on the ability to access funding. In the kind of occasionally painful and tortuous nine-month journey of raising funding for GoodStart, if we did not know where to go to get that money, if we did not have the heavyweight support of people like Robin Crawford, who is chairing GoodStart and who personally underwrote $5 million of that $45 million of social capital, it simply would not have happened. So we need access to people with that sort of horsepower for this market to develop fully.[13]

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11 Mr Christopher Thorn, Executive Director, JB Were, *Committee Hansard*, 1 August 2011, p. 9.

12 Mr Toby Hall, Chief Executive Officer, Mission Australia, *Committee Hansard*, 23 September 2011, p. 55.

13 Mr Michael Traill, Chief Executive Officer, Social Ventures Australia, *Committee Hansard*, 1 August 2011, p. 20.

Intermediaries managing social investment funds

5.15 One way by which intermediaries can leverage capital into the social economy is through managing specific social investment funds. As discussed in chapter 4, a significant barrier preventing institutional investors such as superannuation funds from entering the social economy market is a lack of sufficient deal size and therefore high transaction costs for social investment opportunities. Social investment funds can provide an opportunity to overcome these barriers, allowing intermediary funds managers to aggregate investment opportunities and create the sufficient size to attract large-scale investment. These funds present less risk for institutional investors than investing directly into a single organisation or project in the social economy, and shift the burden of the bulk of the research and due diligence work required from the investors onto the fund manager. This in turn lowers the transaction costs for investors.[14]

5.16 There are a couple of examples of social investment funds operating in Australia. Foresters have established a Social Impact Property Fund, which attracted investment into a fund to purchase commercial property to be leased to community organisations.[15] The two Social Enterprise Development and Investment Funds (SEDIF) recently announced by the federal government to be administered by Foresters and Social Enterprise Finance Australia (SEFA) are another prominent example of this kind of arrangement, where investors put capital into a fund which then provides finance to many social enterprises (see chapter 8).

5.17 Christian Super commented in its submission that working with an intermediary with extensive experience in the social economy sector made it easier for it, as a superannuation fund, to consider channelling investment into the social economy sector.[16] Investment funds managed by intermediaries with extensive sector knowledge provide an alternate investment product for institutional investors and an entry point for the broader investment market:

> The investment through a social investment managed fund provides the wider investment community with an alternative way to obtain exposure to the social economy sector. Investing through a fund allows different funds with different risk profiles to be established to suit varying risk appetites among investors. Additionally, within each fund, different unit classes can be created to cover the whole spectrum of investors such as capital warranty units, subordinate units, senior units, etc. Under the right structure, the units can be bought and sold in the wider market, increasing the liquidity for

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14 Christian Super, *Submission 12*, pp 3–4.

15 Social Investment Australia, 'Investment Products: The Social Impact Property Fund No. 1', http://www.socialinvestmentaustralia.com.au/investment-products/7.html (accessed 7 October 2011).

16 Christian Super, *Submission 12*, p. 3.

investors. This will open up the investor universe for the social economy sector and increase the funding sources and flows mentioned above.[17]

Building capacity and investment readiness in social economy organisations

5.18 As noted in chapter 3, many social economy organisations in Australia are not sufficiently 'investment ready'. These organisations need a variety of support mechanisms to develop capacity to present sound financing propositions and take on debt.[18] The departments' submission noted that 'as in business ventures of all types, expert advice on the most appropriate source and form of finance for the needs and stages of the venture is critical'.[19] Intermediary organisations help social economy organisations become 'investment ready' by providing training, mentoring and expert knowledge and skills. They are aware of the types of finance available and which is most appropriate for a particular organisation, and can match needs with the full spectrum of finance options.[20] The national business development and support service for social enterprises administered by Social Traders (see chapter 8) is an example of this kind of work in Australia.

5.19 The PC report noted that financial intermediaries such as CDFIs usually 'work with NFPs to develop an understanding of their organisational form, capacity and operation as part of the due diligence process prior to investing'.[21] This work has considerable impact; organisations surveyed in the UK reported significant improvements in their revenues and beneficiaries and an ability to raise additional investment as a result of support offered through a social venture intermediary.[22]

5.20 The capacity building work of intermediaries helps to create a pipeline of credible investment opportunities for social investors, which is one of the primary challenges in developing a social capital market.[23] Experience in the UK, where there has been a strong focus over the last decade on the provision of additional capital into the sector, has shown that social investors with capital to invest still often struggle to find enough credible projects in which to invest.[24]

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17 Christian Super, *Submission 12*, pp 3–4.

18 Centre for Social Impact, *Submission 27*, p. 7.

19 DEEWR and PM&C, *Submission 9*, p. 32.

20 DEEWR and PM&C, *Submission 9*, p. 32

21 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 189.

22 DEEWR and PM&C, *Submission 9*, pp. 32–33, xix.

23 Foresters Community Finance, *Supplementary Submission*, p. 1.

24 Cynthia Shanmugalingam et al., *Growing Social Ventures: the role of intermediaries and investors*, February 2011, p. 32.

Providing expert knowledge of the sector

5.21 A crucial role for financial intermediaries is to develop a deep understanding of the sector and social investment issues, enabling them to provide more tailored services than mainstream lenders. JBWere noted that there has often been a mismatch between commercial financial products offered and the real financial needs of NFPs. There is also the risk for financial organisations to get drawn into providing services or capital that they are not set up to provide. Such scenarios have the potential to lead to an erosion of trust and create justifications for providers and investors not to enter the market.[25] Because of this, 'intermediaries who understand the challenges of this market will fulfil an important role in ensuring trust and confidence is built through the utilisation of the right products and services offered to appropriate and informed investors'.[26]

5.22 Because financial intermediaries which focus on providing services to social economy sector organisations are better placed to understand the needs of these organisations than mainstream financial institutions, they can offer a more realistic assessment of the organisation's capacity and ability to repay debt. Intermediaries can offer tailored financial products which account for the often peculiar needs of social organisations. Foresters noted that this process is especially important for the emerging social enterprise sector, stating that intermediaries can potentially channel and structure capital in ways that would not be possible with traditional financial institutions.[27]

The role of financial advisors and planners

5.23 While the prominent financial intermediaries in the Australian context are specialist organisations such as Foresters and SVA, the role of financial advisors and financial planners has also been raised. The Centre for Social Impact (CSI) noted that some mainstream advisors to investors are becoming aware of social investment:

> There are a small number of mainstream advisors to institutional and individual investors that now endorse social investment. These mainstream advisors are restricted by the sole purpose test and fiduciary duties, and rely on recommending ‘investment grade’ investments. A number of specialist advisors have also emerged to address demand for ethical investment and to provide advice around the operation of Private Ancillary Funds (PAFs).[28]

5.24 The Community Council for Australia contended in its submission that financial specialists engaged with the sector are necessary to facilitate increased access to finance for the sector:

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25 JBWere, *Submission 19*, p. 7.

26 JBWere, *Submission 19*, p. 7.

27 Foresters Community Finance, 'Financing Social Enterprise: Understanding Needs and Realities', *Submission 4–attachment 3*, p. 43.

28 Centre for Social Impact, *Submission 27*, p. 7.

> Perhaps even more than other areas, the development of an active and engaged group of finance specialists is an important pre-requisite to establishing more financing options for the NFP sector. To this end, it is important to listen to those from the finance sector who are currently active in this area. If governments, not-for-profits and the community can better support their role, it is much more likely more viable investment and financing options will be developed over time.[29]

5.25 There is a need to increase the awareness among advisors of the opportunities to invest in the social economy. *The Australian Financial Review* recently noted that the potential for philanthropy to be expanded through the role of professional advisors is largely being missed. In order to realise this potential wealth managers, accountants, lawyers and financial advisors need to become informed and engaged with philanthropy and social investment opportunities.[30] Ms Rosemary Addis, Social Innovation Strategist for DEEWR, told the committee that work in this area is occurring overseas, with some philanthropic foundations working to educate financial advisors about options and issues relating to social investment.[31]

5.26 Dr Richard Seymour, from the University of Sydney's Innovation and Entrepreneurship Research Group, noted that the education of executives in the finance sector could occur through short courses managed by private institutions and universities, complemented by formal university courses (see also 5.49-50 below).[32]

Committee view

5.27 The committee considers that there is currently a lack of awareness of social investment issues among financial and philanthropic advisors in Australia. The role of financial and philanthropic advisors in supporting social investment and offering clients information about emerging social investment options needs to be strengthened in Australia. This should be done through educational materials and training courses. The Office for the Not-for-Profit Sector can also play a role in publicising the training and educational opportunities available in this area through its website.

Recommendation 5.1

5.28 The committee recommends that philanthropic and financial advisory services promote and encourage opportunities for social investment and engagement with the sector.

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29 Community Council for Australia, *Submission 15*, p. 5.

30 Gina Anderson, 'Social investors need advice', *Australian Financial Review*, 25 August 2011, p. 63.

31 *Committee Hansard*, 23 October 2011, p. 58.

32 Dr Richard Seymour, The University of Sydney Business School, *Submission 36a*, p. 5.

Community Development Financial Institutions

5.29 The PC report made special mention of CDFIs, a particular type of financial intermediary. The report identified that CDFIs 'increasingly play an essential role in providing credit, financial services and other services to not for profits'. It described these institutions as:

> ...sustainable, mission-driven, independent financial institutions that supply capital and business support to individuals and organisations whose purpose is to create economic opportunity and social capital in disadvantaged communities or underserved markets. CDFIs provide social and financial returns to their investors by using flexible capital products to meet the needs of NFPs to effectively serve these markets while managing their inherent risks.[33]

5.30 CDFIs differ from conventional lenders in that their focus is on underserved markets and their emphasis is on social as well as financial outcomes. They also differ from charitable responses as they do not provide products and services for free.[34]

5.31 The committee has heard from several well established Australian CDFIs, including: Foresters Community Finance, which provides a range of financial products and services to social economy organisations as well administering several social investment funds;[35] Community Sector Banking (CSB), a specialist social sector bank providing banking services to over 5000 not-for-profit organisations around Australia;[36] and Social Ventures Australia, which provides debt and equity investment as well as strategic support to social economy organisations and projects.[37]

5.32 The committee has also heard from organisations with experience operating microenterprise loan funds (a sub-class of CDFIs). Many Rivers Microfinance provides loans to individuals and enterprises which are often unable to obtain finance from mainstream lenders. Many Rivers provided 98 microfinance loans in its first three years of operation, and is significantly scaling up its operations to establish offices in 20 regional centres by 2015.[38] DF Mortimer & Associates operated a microenterprise loan fund between 1998 and 2003, the ‘Landcare Revolving Loan

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33 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 185.

34 Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, pp 17–18, http://www.fahcsia.gov.au/sa/indigenous/funding/CDFI_pilot/Documents/CDFI-ScopingStudy.pdf (accessed 23 May 2011).

35 Foresters Community Finance, *Submission 4*, p. 1; Foresters Community Finance website, www.foresters.org.au (accessed 20 October 2011).

36 Mr Peter Quarmby, Executive Director, Community Sector Banking, *Committee Hansard*, 23 September 2011, p. 51.

37 Social Ventures Australia, *Submission 2*, p. 1.

38 Many Rivers Microfinance, *Submission 26, attachment 1*, pp 1-3.

Fund', which operated in Northeast Victoria providing microfinance loans to farmers to assist them establish farm forestry for commercial and environmental benefits.[39]

Types of CDFIs

5.33 CDFIs take a variety of approaches to supporting underserved sectors of society and creating economic opportunity. They may focus on particular products, geographical communities or social problems. They may focus on supporting individuals or may tailor their services to small businesses and organisations. The main types of CDFIs currently operating internationally are outlined in Diagram 5.1.

Diagram 5.1 Types of CDFIs

Organisational Type	Description & products offered	Who do they serve	Example
Community Development Banks	Regulated for-profit organisations dedicated to social, community or environmental objectives, offering traditional banking services.	Much like mainstream banks they provide products to both individuals and businesses.	Triodos Bank (NE) Community Sector Banking (AUS)
Community Development Credit Unions	Regulated, typically not-for-profit they promote community ownership of assets and savings, and provide affordable consumer credit and retail financial services as well as counselling and business planning assistance.	Focus on financially excluded individuals and communities.	Assiniboine Credit Union (Canada) Street UK (UK) Traditional Credit Union (AUS)
Community Development Loan Funds	Typically self regulated they can take a variety of legal forms (for or non-profit) and areas of focus. For example, small business, affordable housing and non profit organisations.	Typically focus on housing, enterprises and non-profit and community development organisations.	ART (UK) Murex Investments (USA) IBA (AUS)
Community Development Venture Capital Funds	Self regulated, they provide equity and debt investments typically focusing on the scaling of businesses and entrepreneurial capacity.	Typically seek higher levels of return than loan funds, they target enterprises in startup or growth phases in disadvantaged areas.	Pacific Community Ventures (USA) Bridges Community Ventures (UK) Social Ventures Australia (AU)
Micro Loans	Self regulated and generally non-profit, they are a subset of the loan funds category. They provide micro (very small) credit/loan services to individuals and enterprises.	Typically low income individuals and very small businesses.	Adie (France) Grameen Bank (Bangladesh)

Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, p. 19.

39 DF Mortimer & Associates, *Submission 5*, pp 1-2.

5.34 CDFIs obtain funding from a variety of sources, often combining public, philanthropic and private funding. They use a range of approaches to provide products and services to those who normally have difficulty securing finance from commercial lenders. As SVA outlined in its scoping study on CDFIs in Australia:

> The mechanisms that CDFIs use to enable them to operate where commercial providers do not compete include: securing grant funding from government and philanthropic sources; providing products specifically designed to meet the needs of the underserved (such as, mortgages on affordable housing; loan products for non-profit organisations; credit and debit services for people on low-income); gaining access to capital at below market rates (from governments, philanthropic organisations, private investors); lowering operating costs (for example, by using volunteers, operating in spaces with low rent, gaining in-kind infrastructure report from banks).[40]

Current CDFI activity in Australia

5.35 The PC noted that there are currently very few intermediary organisations operating in Australia that could assist NFP organisations to access capital.[41] The SVA scoping study identified less than ten CDFI-like organisations in Australia, operating a total loan portfolio of $150 million. Only six of these organisations offered products or services to NFP and community organisations.[42] The study also noted that there is significant scope for the emergence of a CDFI sector in Australia.

FaHCSIA CDFI Pilot Program

5.36 In January 2010, the federal government announced a CDFI pilot program to be administered by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA). This pilot allocated $7.5 million in funding to 'provide one-off grant funding for business development purposes to selected community finance organisations offering fair, affordable and appropriate products and services aimed at the financial inclusion of disadvantaged Australians'.[43] The pilot is designed

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40 Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, pp 17-18, http://www.fahcsia.gov.au/sa/indigenous/funding/CDFI_pilot/Documents/CDFI-ScopingStudy.pdf (accessed 23 May 2011).

41 Productivity Commission, *Submission 6*, p. 2.

42 Social Ventures Australia Scoping Study, *Community Development Finance Institutions: A new option for addressing financial exclusion in Australia*, December 2009, pp 64–82.

43 Department of Families, Housing, Community Services and Indigenous Affairs, 'Community Development Financial Institution Pilot', http://www.fahcsia.gov.au/sa/indigenous/funding/Pages/CommunityDevelopmentFinancialInstitutionPilot.aspx (accessed 11 May 2011).

to test the CDFI model for addressing financial exclusion by providing capital and infrastructure funding to a small number of Australian CDFIs.[44]

5.37 Under the program, $6 million has been allocated to the successful CDFI applicants to fund operational and business development costs such as technical assistance, product development, operational support or research. This funding has been complemented by capital funds sourced from National Australia Bank and Westpac.[45] By structuring the program in this way, taxpayer money is being provided to help facilitate the establishment of the sector itself rather than simply providing grant capital to organisations. The successful applicants that have been allocated funding are:

- Foresters Community Finance;
- Community Sector Banking;
- Many Rivers Microfinance;
- Fitzroy and Carlton Community Co-operative; and
- Fair Loans Foundation.[46]

5.38 The pilot program is scheduled to run until March 2012. The government has not yet decided whether the program will be continued thereafter.[47] Representatives from FaHCSIA told the committee that the department has also commissioned CSI to explore the legislative and regulatory environment needed to build a sustainable CDFI sector and the role of government in this development. FaHCSIA noted that pursuing the development of a CDFI sector in the longer term will require whole-of-government positioning and coordination.[48]

Financial intermediaries overseas

5.39 Experience in the US and the UK can help inform the development of Australian financial intermediaries such as CDFIs. Both these markets are more advanced than in Australia, and have benefited from government initiatives to encourage the development of the sector.

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44 Ms Robyn Oswald, Manager, Money Management Branch, Department of Families, Housing, Community Services and Indigenous Affairs, *Committee Hansard*, 1 August 2011, p. 2.

45 No further funding for the program has been allocated beyond this round.

46 Ms Robyn Oswald, Manager, Money Management Branch, Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA), *Committee Hansard*, 1 August 2011, p. 2.

47 Ms Robyn Oswald, FaHCSIA, *Committee Hansard*, 1 August 2011, p. 7.

48 Ms Robyn Oswald, FaHCSIA, *Committee Hansard*, 1 August 2011, p. 3.

CDFIs in the United States

5.40 The CDFI sector in the US is relatively well developed compared to most other jurisdictions, with over 1000 CDFIs currently in operation.[49] Seventy per cent of these organisations have been established since the introduction of two major policy initiatives in the 1990s.[50] The majority of CDFIs in the US provide products and services for underserved individuals and businesses, with investment in community groups and social enterprise representing roughly 5 per cent of CDFI investment in 2008.[51]

5.41 In 1977, in response to an inquiry showing a severe shortage in access to finance among low-income communities, the Community Reinvestment Act (CRA) was introduced, which encouraged depository institutions to meet the credit needs of the low income neighbourhoods in their service areas.[52] Lenders are given a CRA rating according to their community finance activities, which is then taken into account by the regulators when approving new branches, mergers and acquisitions. Subsequent amendments to the Act in 1995 explicitly recognised loans and investments in CDFIs as CRA activity. This served as a strong incentive for banks to provide low-cost loans and investments to CDFIs, which were able to leverage these resources to provide community development finance activities.[53]

5.42 In 1994, the Clinton Administration also established the CDFI Fund, a government body which provides capital funding grants, equity investments and awards for technical assistance for CDFIs through a variety of programs.[54] As well as providing direct funding through Financial and Technical Assistance Awards, the CDFI fund also delivers targeted funding through several programs aimed at specific areas within the sector including affordable housing and Native American initiatives. The Fund also administers the New Markets Tax Credit Program, which permits taxpayers to receive a credit against income taxes for making equity investments in designated Community Development Entities such as CDFIs.

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49 Foresters Community Finance, *Submission 4–attachment 1*, 'Financial Inclusion, market failures and new markets: Possibilities for Community Development Finance Institutions in Australia', October 2008, p. 41.

50 Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, p. 22.

51 CDFI Data Project Publication Committee, *Providing Capital, Building Communities, Creating Impact: Fiscal Year 2008*, p. 9, http://opportunityfinance.net/store/downloads/cdp_fy2008.pdf (accessed 2 June 2011).

52 US Federal Financial Institutions Examination Council, *Community Reinvestment Act: Background and Purpose*, http://www.ffiec.gov/cra/history.htm (accessed 12 May 2011).

53 Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, p. 21.

54 Coalition of Community Development Financial Institutions, *What is the CDFI Fund?*, http://cdfi.org/index.php?page=info-1a (accessed 12 May 2011).

5.43 Since its establishment in 1994, the Fund has awarded over US$1.1 billion to community development organisations and financial institutions, as well as attracting private-sector investments to the sector totalling US$29 billion through its New Markets Tax Credits program.[55]

5.44 Recent experience in the US shows that CDFIs are not immune from the fluctuations that affect the finance industry as a whole. One of the largest and longest-running CDFIs, the Chicago based ShoreBank, suffered significant losses in the aftermath of the US recession that followed the 2008 global credit crunch, and was subsequently declared insolvent and closed by US regulators in August 2010.[56]

CDFIs in the United Kingdom

5.45 The CDFI sector in the UK has seen significant growth over the last 15 years, with key support from the government. In response to a report published in 2000 by the UK government's Social Investment Task Force, several measures were put in place to help develop the CDFI sector. These included:

- establishing the Phoenix Challenge Fund, which from 2000 to 2006 distributed approximately £42 million to around 60 CDFIs in the form of revenue grants to support operational costs, capital grants for on-lending to businesses, and a loan guarantee fund to stimulate banks and other organisations to lend money to CDFIs;[57]
- the introduction of a Community Investment Tax Credit (CITR), which allows those who invest in approved CDFIs to receive an income or corporation tax deduction to the value of 25 per cent of the investment;[58]
- establishing a Community Development Venture Fund (Bridges Community Ventures) to provide equity and new equity capital for CDFIs, with £20 million in initial government funds matched by £20 million from private investors;[59] and

55 US Department of the Treasury, *About the CDFI Fund*, http://www.cdfifund.gov/who_we_are/about_us.asp (accessed 12 May 2011).

56 Nick Carey, Reuters, *Regulators Close ShoreBank in Chicago*, 21 August 2010, http://www.reuters.com/article/2010/08/21/us-shorebank-failure-idUSTRE67J5AE20100821 (accessed 20 October 2011).

57 GHK, *Evaluation of Community Development Finance Institutions (CDFIs)*, March 2010, p. 13.

58 HM Revenue and Customs, *Community investment tax relief manual: Brief guide for investors*, http://www.hmrc.gov.uk/manuals/citmanual/CITM9900.htm#IDAGFY2C (accessed 25 May 2011).

59 Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, p. 24.

- the provision of initial funding for the establishment of the Community Development Finance Association (CDFA), a trade association for the CDFI sector which continues to receive ongoing government funding.[60]

5.46 These measures saw the number of CDFIs in the UK grow rapidly, with the CDFA reporting 66 operating CDFIs in the UK in 2010.[61] Data from the CDFA indicates that roughly 40 per cent of CDFIs in the UK offer products and services to NFP and community organisations.[62] Public sector funding has been vital to the CDFI industry in the UK, and a 2010 government-commissioned review of the sector recommended that the public sector continue to support CDFIs in the UK.[63]

Non-financial intermediaries

5.47 As well as financial intermediaries, various other types of intermediary organisations may play a role in strengthening the development of social organisations in the creation of a social economy capital market. As mentioned earlier in this chapter, these intermediaries work in the areas of people, network and expertise; monitoring; marketing and distribution; and innovation.[64]

Capacity building intermediaries

5.48 As well as support relating to financial investment readiness, intermediaries offer support services that assist organisations build their capacity more broadly. As CSI stated in its submission, 'intermediary organisations such as legal practices, accounting firms, professional advisory services, IT services and governance support organisations [are] also a necessary component of a capital market'.[65]

5.49 There are a number of intermediary organisations in Australia that offer advice and assistance to NFPs on legal issues such as choosing a legal structure. CSI noted that some law firms provide pro-bono or low fee support to social economy organisations, but the delivery of these services remains relatively ad-hoc and not systematically tailored to the needs of social economy organisations, especially with

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60 Community Development Finance Association, *About the CDFA*, http://www.cdfa.org.uk/about-cdfa/ (accessed 30 May 2011).

61 Community Development Finance Association, *Inside Out 2010: The State of Community Development Finance*, December 2010, p. 7, http://www.cdfa.org.uk/wp-content/uploads/2010/12/Inside-Out-20101.pdf (accessed 24 May 2011).

62 Community Development Finance Association, *Inside Out 2010: The State of Community Development Finance*, December 2010, p. 11.

63 GHK, *Evaluation of Community Development Finance Institutions (CDFIs)*, March 2010, p. ix, http://www.bis.gov.uk/assets/biscore/enterprise/docs/10-814-evaluation-community-development-finance-institutions (accessed 12 October 2011).

64 DEEWR and PM&C, *Submission 9*, p. 32.

65 Centre for Social Impact, *Submission 27*, p. 7.

respect to attracting investment.[66] A small number of organisations do offer tailored support, such as PILCH Connect, a Victorian firm offering comprehensive legal advice and services to not-for-profit organisations. The Australian Charity Law Association also provides advice and support to the sector. Ms Juanita Pope, Senior lawyer for PILCH Connect, informed the committee of the importance for social organisations to receive appropriate legal advice:

> We would submit that barriers to accessing legal assistance have a direct connection with the availability of finance to not-for-profits. For example, a charitable group that receives good legal advice in its incorporation stage will be better placed to access tax concessions, such as DGR, that are often needed for finance...
>
> We see our service as an effective model for supporting not-for-profits with their legal and legally related issues, and the advice that we can provide and the assistance that we give to build capacity to not-for-profit groups can help them to access finance opportunities or even, indeed, assess the situation that they are in and contemplate their options.[67]

5.50 Other networking and educational organisations provide additional support services such as management and governance support, business development, strategic planning and other training services for social organisations. In Australia, organisations such as Matrix On Board provide consultancy and training services in these areas.[68] Another capacity building organisation, Our Community, reaches over 55 000 member community groups with a range of services including a website with comprehensive information and educational materials, a training company, newsletters and technology initiatives.[69] Our Community told the committee that they had completed work with Westpac Bank to create around 120 000 free educational guides to distribute to community organisations covering three topic areas: a guide for community treasurers; a guide for community groups looking to invest their funds; and a guide for NFP board members helping them to understand company balance sheets and manage a set of organisational accounts.[70]

Education and research for the sector

5.51 The committee has heard that teaching programs for social enterprises, incorporating expertise such as managerial finance, strategic management and

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66 Centre for Social Impact, *Submission 27*, p. 7.

67 Ms Juanita Pope, Senior Lawyer, PILCH Connect, *Committee Hansard*, 9 September 2011, p. 52.

68 Ms Nonie Wales, Managing Director for People and Culture, Matrix On Board, *Committee Hansard*, 9 September 2011, p. 52.

69 Mr Dennis Moriarty, Managing Director, Our Community, *Committee Hansard*, 9 September 2011, p. 51.

70 Mr Dennis Moriarty, Managing Director, Our Community, *Committee Hansard*, 9 September 2011, p. 56.

enterprise development, will help build the capacity required for organisations to take advantage of new funding opportunities.[71] The need for ongoing academic research to support the sector was also highlighted.[72]

5.52 Several organisations in Australia are offering teaching courses in this area. CSI, which was established in 2008 as a collaboration between the business schools of four Australian universities,[73] offers a one year Graduate Certificate in Social Impact, covering areas such as social investment, corporate responsibility, leadership for social impact and social impact measurement.[74] The University of Sydney Business School has been teaching a specialist postgraduate unit on Social Entrepreneurship as part of its Innovation and Enterprise teaching program. The School for Social Entrepreneurs Australia offers a nine month program to support aspiring social entrepreneurs in establishing social enterprises.[75]

5.53 There are also several Australian academic groups undertaking research in the areas of social innovation, impact investment, philanthropy, social enterprise and governance. CSI has completed studies on financial exclusion in Australia, microenterprise, social procurement, workplace giving, social impact bonds and NFP governance.[76] The Australian Centre for Philanthropy and Nonprofit Studies at the Queensland University of Technology undertakes research on social enterprise, charity law, nonprofit governance and regulation.[77] The University of Sydney Business School is conducting research relating to social enterprise, including a partnership with Social Enterprise Finance Australia to undertake research relating to the SEDIF initiative.[78]

5.54 Internationally, philanthropic foundations have also played a leading role in developing the dialogue, research base and practise for social impact investment and the social economy.[79]

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71 Dr Richard Seymour, The University of Sydney Business School, *Submission 36*, p. 2.

72 *Submission 36*, p. 2.

73 The University of New South Wales, the University of Melbourne, Swinburne University of Technology and the University of Western Australia.

74 Centre for Social Impact, 'Postgraduate Program: Course Descriptions', http://www.csi.edu.au/site/Postgraduate_Program/Course_descriptions.aspx (accessed 12 October 2011).

75 Mr Benny Callaghan, Chief Executive Officer, School for Social Entrepreneurs Australia, *Committee Hansard*, 23 September 2011, p. 9.

76 Centre for Social Impact, 'Research Projects', http://www.csi.edu.au/site/Research_Projects/Research_projects.aspx (accessed 7 November 2011).

77 The Australian Centre for Philanthropy and Nonprofit Studies, http://www.bus.qut.edu.au/research/cpns/ (accessed 12 October 2011).

78 Dr Richard Seymour, The University of Sydney Business School, *Submission 36*, p. 3.

79 DEEWR and PM&C, *Submission 9*, p. 33.

Developing market infrastructure and measurement frameworks

5.55 Intermediaries can help provide the necessary infrastructure for the development of a social capital market. This infrastructure includes common language, robust and accepted performance metrics and publicly available benchmarking data (see chapter 7).[80] CSI outlined the need for effective measurement and evaluation frameworks in its submission:

> The role of effective measurement and evaluation frameworks forms a necessary foundation for a capital market for social economy organisations. This can ameliorate the considerable level of information asymmetry between parties to social investment. To encourage the 'blending' or 'sharing' of social and financial value there must be effective measurement, evaluation and reporting frameworks. The integration of multiple sources of value in a single reporting approach is the aim of the International Integrated Reporting Committee's Integrated Reporting Framework, with a discussion paper due for release later in 2011. In addition, the Impact Reporting and Investment Standards (IRIS) is developing an independent and credible set of metrics for measuring social and environmental performance and the Global Impact Investing Rating System (GIIRS) is exploring a ratings approach to assessing social and environmental impact.[81]

5.56 Market infrastructure such as trading platforms also supports the linkages between investors and the social economy sector. In Australia, the Indigenous Stock Exchange (ISX) has performed this function in the area of Indigenous businesses and social enterprise. The ISX website allows indigenous entrepreneurs seeking funding to list details of their projects onto online 'trading floors' which potential investors can then view.[82] This aggregation of potential investment opportunities into one location can thus create linkages between entrepreneurs and investors. The aggregation of potential targets for philanthropic donations is also being realised through organisations such as Karma Currency Foundation, which operates a charitable gift registry allowing individuals and organisations to choose from over 1000 charitable projects to which they can donate.[83]

5.57 In addition to platforms which aggregate information about social investment projects, there is also potential for the creation of centralised platforms which offer performance data and evaluative information about particular social investment opportunities. JBWere suggested in its submission that the government could fund an independent NFP ratings agency for impact investments, helping to provide

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80 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 8.

81 Centre for Social Impact, *Submission 27*, pp 7–8.

82 Indigenous Stock Exchange, 'About Us: Supporting People with Dreams', http://www.isx.org.au/about/ (accessed 13 October 2011).

83 Mr Ashley Rosshandler, Founder and Chief Executive Officer, Karma Currency Foundation, *Committee Hansard*, 9 September 2011, p. 53.

transparency and accountability in the market, protecting and informing investors.[84] Under this proposal, the ratings agency would use criteria such as social impact, financial return and risk to derive a rating or series of ratings to allow investors to adequately compare investments and match them to their needs. These ratings would be complemented by additional information about the organisation and the investment opportunities being offered, giving potential investors the best possible advice. Mr Thorn of JBWere commented:

> ...in terms of the rating piece, it is really around creating a body of research that enables the not-for-profits to become more investment-ready and understand what they need to do to attract social capital in its various forms and it also helps potential investors understand—if they put their money in and they accept a social discount—the value they are generating for the discount they are receiving.[85]

Investing in innovation in the sector

5.58 Intermediary organisations can also help drive innovation in the sector. This can include investing in and supporting start-up and innovative social ventures, as well as developing new financial products and investment opportunities for the sector.

5.59 The SEDIF initiative, administered through the finance intermediaries Foresters and SEFA, includes funding to be directed to early stage and start-up social enterprises (see chapter 8). These 'incubator' funds are seen as a way of promoting innovative ideas in social enterprise. The Cape York Institute contended in its submission that funding for innovation and early stage social impact programs could be extended to ventures which do not derive income from trade:

> While the current SEDIF model currently invests in innovation and supports capability development, it has neither the mandate nor the scale to support social impact programs that do not "derive a substantial portion of their income from trade and reinvest the majority of their profit/surplus in the fulfilment of their mission".
>
> A broader Social Investment Fund could play a similar role for all social impact programs. This could be a philanthropic type model that supports program development and directs investment of grants and donations, such as the Venture Philanthropy Company. Alternatively it could be an expansion of the current SEDIF model to enable investment in social impact programs whose business model allows for sustainability.[86]

5.60 Moreover, intermediaries can help develop new and innovative financial products for the social impact investment market. This has happened in the UK with the development of new social investment vehicles such as social impact bonds (discussed further in chapter 6).

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84 JBWere, *Submission 19*, pp 18–19.

85 Mr Christopher Thorn, Executive Director, JBWere, *Committee Hansard*, 1 August 2011, p. 13.

86 Cape York Institute for Policy and Leadership, *Submission 31*, p. 16.

Developing the intermediary market in Australia

5.61 As has been noted, intermediary services for social economy organisations are lacking in Australia, particularly financial intermediaries. The PC noted in its submission to the inquiry that there could be several reasons for this state of affairs:

> ...the failure of intermediary or support services to develop may reflect the ad hoc nature of the funding building capacity in the NFP sector. In part this is because such services require some continuity in their funding to be viable, but it is also because most NFPs fail to recognise the value to their enterprise of hiring such intermediary services.[87]

5.62 Participants in this inquiry have been supportive of the attempts by government to stimulate investment in the market through intermediary-managed initiatives. As Ms Kylie Charlton, an expert in impact investment and social innovation, told the committee:

> A number of recent initiatives of the Australian Government such as the SEDIF and the pilot for Community Development Financial Institutions (CDFIs), along with the announcement by NSW Government to pilot Social Benefit Bonds, serve to commence the process of developing efficient intermediation. These initiatives will help to establish demonstrative funds, develop backable fund managers and create accessible investment product, and are commendable first steps. It is likely however that further similar or complimentary initiatives will be needed to effectively address the challenge of intermediation.[88]

Developing links between intermediaries

5.63 Many intermediaries provide multiple services to organisations, and there is a need for social organisations to be able to access intermediary services across all the areas canvassed in this chapter. The interrelated nature of intermediation to the sector was highlighted by Ms Pope from PILCH Connect:

> Our submission is that a network of intermediary services is critical, and our services work with each other in order to support not-for-profits. Our services are often contingent on the supports of other intermediaries.[89]

5.64 Some positive collaborations are already happening in Australia, including linkages between academic groups and finance intermediaries. The strengthening of these kinds of collaborations and intermediary networks will be crucial to developing efficiencies and economies of scale within the social economy, and need to be encouraged.

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87 Productivity Commission, *Submission 6*, p. 2.

88 Ms Kylie Charlton, private capacity, *Committee Hansard*, 26 September 2011, p. 8.

89 Ms Juanita Pope, Senior Lawyer, PILCH Connect, *Committee Hansard*, 9 September 2011, p. 52.

Encouraging financial intermediaries in Australia

5.65 Foresters outlined in a 2008 research paper the factors it sees as crucial to the development of a CDFI sector in Australia, namely:

- an enabling policy and regulatory environment for CDFIs;
- the adoption of realistic timeframes for development in the sector over the long term;
- the development of partnerships between CDFIs and mainstream financial institutions;
- encouraging innovative models for CDFI development;
- a CDFI peak body and high profile 'champions' for the sector; and
- development of good evaluation tools for the sector.[90]

5.66 The SVA scoping study undertaken for the FaHCSIA pilot program also commented on what may be required to develop a CDFI sector:

> Fostering a strong, viable CDFI sector in Australia will require ongoing government support, including: provision of access to low- or no-cost wholesale government-sourced loan capital; establishment of tax incentives to encourage private and philanthropic investment in CDFIs; and, the allocation of grants to support product development or infrastructure.
>
> Mounting a comprehensive program for nurturing CDFIs across Australia will entail securing the support of many stakeholders, as well as a significant lead time.[91]

5.67 The PC report argued for the possibility of CDFIs leading the development of a market for NFP debt products, stating that Australian governments should consider initiatives to grow existing CDFIs and develop new CDFIs to encourage competition and awareness. The report noted that both start-up funding and ongoing support for development activities may be required, but took the view that government support should not be extended to establishing a capital fund from which CDFIs can borrow.[92] The PC report recommended at the time of its inquiry that Australian governments explore options to encourage CDFIs to develop appropriate financial products and services for the NFP sector.[93]

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90 Foresters Community Finance, *Submission 4–attachment 1*, 'Financial Inclusion, market failures and new markets: Possibilities for Community Development Finance Institutions in Australia', October 2008, pp 42–43.

91 Department of Families, Housing, Community Services and Indigenous Affairs, 'Community Development Financial Institution Scoping Study', http://www.fahcsia.gov.au/sa/communities/pubs/CDFI_pilot/Documents/exec_summary.htm (accessed 7 November 2011).

92 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 190.

93 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 194.

The difficulty of financing intermediary work

5.68 Many Rivers contended in its submission that intermediaries can have full and unlimited access to loan capital from current financial markets if they maintain a good repayment rate on loans, incorporate a bad debt provision that is fully funded into their business model and keep their costs at a reasonable and low level.[94]

5.69 Other witnesses argued, however, that financing the work of intermediary organisations such as CDFIs can be particularly difficult.[95] Foresters told the committee that it is likely the CDFI sector in Australia would require ongoing subsidisation to some extent to operate effectively:

> There is some debate about whether CDFIs can ever be fully self-sustaining or whether they really require a mix of income. Certainly, the unfortunate demise of a large CDFI in the US recently, ShoreBank, indicates that some external subsidisation on an ongoing basis is probably required for these institutions to continue to operate effectively. But the comfort for government there is that it gets to the double bang for its buck in a way, because the government investment is matched by generated income to fulfil a social purpose.[96]

5.70 This sentiment was echoed by Mr Ian Gill, Chief Executive Officer of Ecotrust Australia, talking about his experience working with CDFIs in the US and Canada:

> ...in my experience with community development financial institutions, they almost universally do not pay their way on a year-to-year basis, purely through the market value of the transactions that they do. Frankly I am always a bit suspicious of a CDFI that is either making a profit or paying its own way, because the whole point of a CDFI from my point of view is to go into non-market-ready or higher risk areas and do the loans that conventional financial institutions will not do. If they are making money at doing that, they have probably become too conservative in their loan book, and I have seen that happen time and time again. My rule of thumb is that, if a CDFI is generating about 70 per cent of its required revenue a year though its loan book and needs to find 30 per cent in subsidies from somewhere else, that is a good thing; I do not think that should be treated as a bad thing. But that does require a bit of a cultural change to some degree.[97]

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94 Many Rivers Microfinance, *Submission 26*, p. 2.

95 Dr Ingrid Burkett, Managing Director, Knode Pty Ltd, *Committee Hansard*, 9 September 2011, p. 34.

96 Ms Therese Wilson, Chairperson, Foresters Community Finance, *Committee Hansard*, 1 August 2011, p. 34.

97 Mr Ian Gill, Chief Executive Officer, Ecotrust, *Committee Hansard*, 23 September 2011, p. 16.

5.71 The committee has heard that government could help some overcome the challenges associated with financing intermediary work by providing direct support to CDFIs and through encouraging private sector investment in these organisations.

Should government provide long-term direct support for the sector?

5.72 The committee has heard mixed views about whether or not government should provide financial support to the CDFI sector in Australia on an ongoing basis. The scoping paper undertaken in 2009 by SVA for the current CDFI pilot program suggested that a sustainable Australian CDFI sector would require ongoing government financial support.[98] The PC report, while acknowledging that both start-up and organisational funding may be required for the sector, recommended that any government financial support for the CDFI sector should be time limited, so as to ensure the long term sustainability of the sector.[99] Mr Robert Fitzgerald, the commissioner of the PC inquiry into the NFP sector , explained to the committee why the commission took this approach at the time of its report, noting that ongoing funding for CDFIs may be worth considering in the future:

> ...The CDFIs are an emerging and exceptionally important financing source for the sector. We believe the government should encourage their growth and development. We believe that the work done so far in Australia but also overseas gives us confidence that this particular area, CDFIs, can be a very significant contributor to the financing of the sector. There are a number of ways to approach that in terms of government support. The view of the commission, as I indicated, was that wherever the market is responding then the role of government is not to overly intervene in that. We identified that CDFIs could be provided with access to capital by the government in their establishment or developmental phases, but that would be a short-term arrangement. In other words, we did not see government as an ongoing or permanent pool of funding for the CDFIs. You can do that. Both in North America and in Britain we have seen various models. The difficulty is one of principle and risk to the government. To what extent should in fact the government be a funder of these CDFIs? What are the risk inherent in that? Are there issues around moral hazards and so on? Our view was to say the government should be supportive. One of those could be short-term funding, particularly in the development phase. We were less convinced that long-term funding of the CDFIs was appropriate. Nevertheless, other countries have done so and, as I have indicated to you, there may be evidence that warrants a rethinking of that particular issue, but that was our view at the time.[100]

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98 Social Ventures Australia Scoping Study, *Community Development Finance Institutions (CDFIs): A new option for addressing financial exclusion in Australia*, December 2009, pp 50–52.

99 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, p. 194.

100 Mr Robert Fitzgerald, Commissioner, Productivity Commission, *Committee Hansard*, 26 September 2011, pp 21–22.

5.73 Dr Ingrid Burkett noted that too much government support for intermediaries can lead to an overdependence on grant funding in intermediary organisations, which does not set a good example for the organisations intermediaries work with:

> Senator STEPHENS: ...The evidence that we had from our Canberra hearing was that to grow a social capital market in Australia we actually need to invest in intermediary services and that that should be the responsibility of government. If government wants to grow a social capital market and create these new sources of finance then it has to do more than enable, it actually has to invest in the intermediary services. Would you have a comment on that?
>
> Dr Burkett: Yes. I think intermediary services are absolutely fundamental to the growth of this sort of new social capital market or impact investment. Where I think there is a glitch is if we create a raft of intermediaries who are not social enterprises in their own right, who act like the traditional not-for-profit organisation and are totally grant funded, and then advise their constituents, if you like, not to do as they do. So, I think that is a real tension because the work of intermediaries is quite difficult to finance and we need innovation in that space.[101]

5.74 Christian Super argued in its submission that CDFIs need some level of government support to maintain their financial health over the longer term:

> Our experience assessing CDFIs has reviewed that their financial health on a stand-alone basis is not sufficient to carry out all the work they need to do to help CSOs [Community Sector Organisations] have access to funding. Our experience further informs us that the existence of some level of government support is necessary to attract and retain investors and ensure that more of CDFIs exist to help the sector...
>
> Most of the CSOs that are helped by CDFIs need more long term funding than short term funding hence the need for a government commitment to funding CDFIs (and their investors) for the long term to give confidence that the CDFIs will be able to carry out their duties throughout the duration of the investment. [102]

5.75 Christian Super list possible options for government support to the CDFI sector as: long term funding for the acquisition of assets and short term operational costs of CDFIs; educating the investor and social economy sectors on funding options and performance measurement for the social economy; and encouraging the aggregating of capital raising across multiple social economy organisations through shared investment platforms.[103]

5.76 DF Mortimer and Associates argued that government support of microenterprise loan funds is a cost effective expenditure of public monies towards

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101 *Committee Hansard*, 9 September 2011, p. 34.

102 Christian Super, *Submission 12*, pp 4–5.

103 Christian Super, *Submission 12*, pp 4–5.

identified social problems, particularly because grants of loan capital to micro-enterprise loan funds will be recycled many times over.[104]

5.77 The forthcoming CSI study, commissioned by FaHCSIA and to be released in the coming months, will help inform the debate about the role of government support for CDFIs and financial intermediaries more generally.

Encouraging private sector investment in intermediaries

5.78 As well as the option for government to provide funding directly to CDFIs, legislative measures could be used to encourage private sector investment into CDFIs and other financial intermediaries. CSB stated in its submission that the CDFI market in Australia should be developed in a manner that maximises co-contributions from corporate, philanthropic and social investor markets, and contended that the success of initiatives such as the CDFI pilot (in which it is a participant) and SEDIF would be enhanced if there was an appropriate legislative framework and incentives to mobilise markets towards investing in CDFIs.[105]

5.79 Some partnership approaches are emerging in this area. Many Rivers operates in partnership with Westpac, providing banking infrastructure and loan funds to small enterprises through a 'real' Westpac business loan. In this arrangement Westpac provides the loan capital while Many Rivers retains control over lending decisions.[106] This kind of model is to be encouraged, as it utilises the strengths of both the mainstream bank (in providing capital, organisational support and advice) and the intermediary (close knowledge of the target communities and organisations).

5.80 The committee has heard that tax incentives and funding guarantees could both be utilised to attract private investment. Experience from the US and UK shows that any tax incentives need to be carefully structured. The New Markets Tax Credits program has been highly successful in the US, attracting over US$29 billion in private investment into the sector since its inception. In contrast, the Community Investment Tax Relief (CITR) program in the UK has not generated as much investment in the sector as initially envisaged. This is largely due to the initial narrow scope of the incentive scheme, which excluded investments in organisations providing personal finance or finance for the purchase of property.[107] The UK government is currently working to review the CITR scheme and how its effectiveness can be increased.

5.81 Christian Super noted that funding guarantees from government, or government involvement with a CDFI generally, could lower the risk profile of CDFIs

104 DF Mortimer & Associates, *Submission 5*, p. 5.

105 Community Sector Banking, *Submission 10*, pp 6, 11.

106 Many Rivers Microfinance, *Submission 26, attachment 3*, pp 1-2.

107 Sir Ronald Cohen, Founder and Former Director, Social Finance Ltd, *Committee Hansard*, 1 August 2011, p. 69.

and thus encourage institutional investment.[108] As noted in chapter 4, government involvement was one of the principle reasons Christian Super felt comfortable investing in the SEDIF initiative. The PC report suggested that the provision of government guarantees for private investors may hinder the development of an efficient market in the long term, but that government intervention in such areas may be warranted in specific circumstances.[109]

5.82 Encouraging partnership approaches between CDFIs and mainstream financial institutions is another approach to strengthening the emerging CDFI sector. FaHCSIA told the committee in relation to the current CDFI pilot: 'Leveraging investment by the banks to work with CDFIs is a central element of the project. It is clear that the involvement of major banks is a critical component for the sustainability of CDFIs in the medium to longer term'.[110]

Wholesale social investment banks

5.83 The committee has heard that social investment banks and wholesale providers of social investment capital can play a role stimulating the provision of capital to intermediary organisations. These wholesale lenders can provide finance to a range of financial and other intermediary organisations, providing an additional layer of capital for the sector.[111] A wholesale social investment bank is also more likely to attract large-scale commercial investment for channelling into the sector.

UK Big Society Capital

5.84 The Social Investment Task Force in the UK, which operated from 2000 to 2010, considered that for social capital markets to be fully developed in the UK there needed to be a wholesale institution designed specifically to channel capital into the social economy. In July 2010, British Prime Minister David Cameron announced that the government was looking to establish a 'big society bank' in the UK to provide this role.[112] Sir Ronald Cohen described the function of this bank as being 'a financial engine for the social sector, attracting capital by blending social returns with financial returns and tax incentives'.[113]

5.85 The 'big society bank' concept was brought to fruition with the launch of Big Society Capital Group on 28 July 2011. The group has an initial capital input of £600

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108 Christian Super, *Submission 12*, pp 4–5.

109 Productivity Commission, *Contribution of the Not-for-Profit Sector*, January 2010, pp 190, 192–193.

110 Ms Robyn Oswald, Branch Manager, Money Management Branch, FaHCSIA, *Committee Hansard*, 1 August 2011, p. 2.

111 Centre for Social Impact, *Submission 27*, p. 5.

112 Sir Ronald Cohen, Social Finance Ltd, *Submission 16*, pp 8–9.

113 *Submission 16*, p. 9.

million. This capital consists of £400 million sourced from unclaimed assets left dormant in UK bank accounts for over 15 years, as well as £200 million in equity capital from four of UK's largest mainstream banks.[114] Big Society Capital (BSC) describes itself as a financial institution that aims to develop a market for investment made on the basis of positive social impact as well as financial returns, in order to boost the ability of social enterprises, voluntary and community organisations to deal with social issues.[115]

5.86 The group's proposal to the UK government in May 2011 stated that its two key roles are to be a wholesale investor in the sector as well as a social investment champion. It plans to act as a wholesale investor into the social economy sector through:

- co-investment of equity or debt in social investment funds managed by intermediaries;
- provision of subordinated capital such as affordable loan finance, equity and quasi-equity investments to social investment intermediaries and funds;
- investment in existing intermediaries through long term equity investments;
- investment in infrastructure organisations supporting the sector; and
- investment and underwriting for innovative financial products such as social impact bonds (see chapter 6).[116]

5.87 BSC also seeks to be a champion for the social investment sector, through information sharing and networking, research, capacity building, promoting best practice in the industry and the provision of advice on market development for the social economy sector.[117] Prime Minister Cameron commented on the role of BSC at its launch in July 2011:

> I've seen the amazing work that Britain's social enterprises already do to tackle some of our country's most intractable problems. I believe that Big Society Capital will play a major role in injecting significant resources and financial innovation into these social enterprises, while at the same time attracting further funding from charitable foundations, private individuals and other investors.[118]

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114 UK Cabinet Office, 'Big Society Capital: Big Society Bank launched', Media release, 28 July 2011, tabled by Sir Ronald Cohen at a public hearing in Canberra on 1 August 2011.

115 Big Society Capital website, http://www.bigsocietycapital.com/ (accessed 20 September 2011).

116 Social Finance Ltd, 'The Big Society Bank ("BSB") Outline Proposal', *Submission 16–attachment*, pp 4–5.

117 Social Finance Ltd, 'The Big Society Bank ("BSB") Outline Proposal', *Submission 16–attachment*, pp 6–7.

118 UK Cabinet Office, 'Big Society Bank launched', 28 July 2011, pp 2–3, tabled by Sir Ronald Cohen at a public hearing in Canberra on 1 August 2011.

5.88 BSC represents a large injection of public capital into the social investment market in the UK. The press release announcing the launch of BSC stated that it 'will be run independently from government with decisions around funding being made by an impartial investment committee'.[119] Mr Glen Saunders from Triodos Bank expressed concern that such a large provision of public capital could have distortionary effects on the market in the UK:

> Senator STEPHENS: Do you want to make any comments about the Big Society Bank?
>
> Mr Saunders: That is an excellent example of what I was just saying. I wish it would not happen. It is basically a government initiative. There is a well developed market, with quite a number of different social lending initiatives in the UK. You get the Big Society Bank, which becomes dominated by political interests—things people want to develop and so on—and so everybody starts to chase those pounds, in that case, and it distorts the market.
>
> Our preference would be that the government use its influence and funding to remove barriers rather than to try to do it itself, which is what the Big Society Bank is really doing. Triodos in the UK, as these things go, has to be involved with that, but we would rather it was not happening.[120]

Potential for a wholesale social investment bank in Australia

5.89 Mr Greg Peel, Chief Executive Officer of CSB, argued that a wholesale funder operating like BSC could help mobilise capital into the sector in Australia:

> We have just come back from a trip to Big Society Capital. I think that style of structure is an excellent way, if we use that capital rightly, to mobilise the markets again—not just as a pure investor in social enterprise but as a leverage tool to maximise co-contributions for the market—and that would be a really important part of this.[121]

5.90 Mr Les Hems from CSI told the committee that a wholesale social investment bank could help drive institutional investment into the social economy sector:

> It is actually the functioning of the wholesale bank that is the crucial thing, because that can be driving funds co-investing in funds like the SEDIF and the CDFIs. I think it will open up the funds to a broader set of policy issues. I am thinking here particularly in terms of the affordable housing and funding community housing organisations that may be a beneficiary of a wholesale investment bank which is targeting social impact as well as financial return....

119 UK Cabinet Office, 'Big Society Bank launched', 28 July 2011, p. 2, tabled by Sir Ronald Cohen at a public hearing in Canberra on 1 August 2011.

120 Mr Glen Saunders, Director, Triodos Bank, *Committee Hansard*, 9 September 2011, p. 7.

121 *Committee Hansard*, 23 September 2011, p. 52.

> We think the institutional investors will feel more comfortable investing in a wholesale social investment bank, like Big Society Bank, rather than the individual funds. We know that deal size is a big issue for super funds and so on. So the wholesale social investment bank is perhaps a domain where we get institutional investors involved and allow the more retail investors to get involved in subfunds, which are related to policy areas where they may have an emotive link as well as a desire to at least get their capital back and a suitable return on their capital.[122]

5.91 Following on from Diagram 4.1 (see p. 62), diagram 5.2 outlines the role a wholesale social investment bank could play in capitalising the social economy in Australia, providing funds to financial intermediaries and social investment funds, while leveraging investment from institutional investors and mainstream financial institutions.

5.92 Currently there are no social investment banks operating in Australia, and raising the initial capital for such an organisation would be a primary challenge. BSC sourced the majority of its initial capital from unclaimed monies in dormant bank accounts. In Australia there is over $636 million in unclaimed money held in dormant accounts,[123] however existing provisions already provide for unclaimed assets from Australian bank accounts to be transferred to the Commonwealth after a period of seven years,[124] making the reallocation of these funds more difficult.

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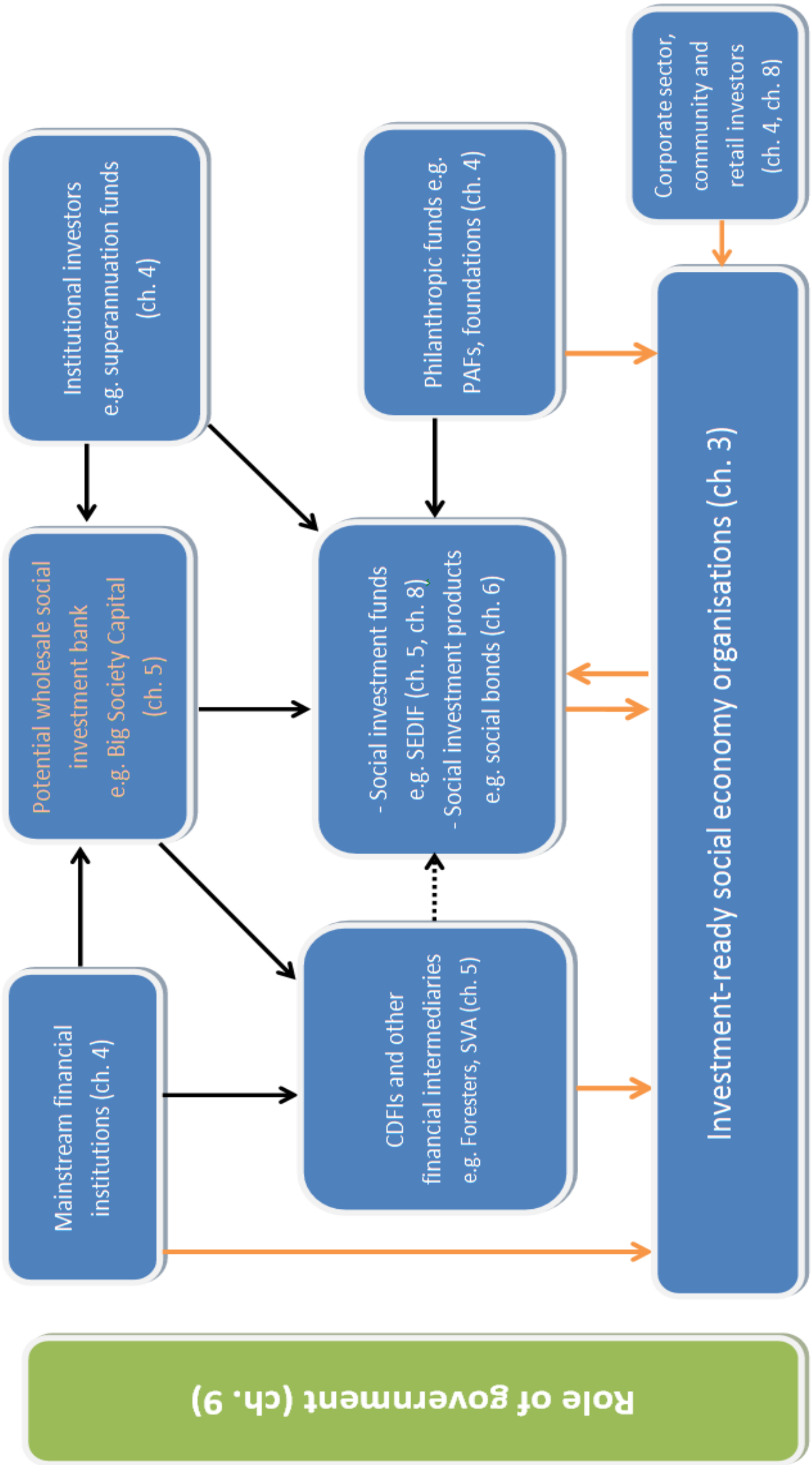
122 Mr Les Hems, Director of Research, Centre for Social Impact, *Committee Hansard*, pp 40–41.

123 Australian Associated Press, 'Unclaimed Funds top $636 million', *The Age*, 25 October 2011, http://www.theage.com.au/money/saving/unclaimed-funds-top-636-million-20111025-1mgwf.html (accessed 27 October 2011).

124 *Banking Act 1959*, s. 69.

Diagram 5.2: Possible investment flows in a social economy capital market (with a wholesale social investment bank).



Committee secretariat, adapted from Centre for Social Impact, *Submission 27*, p. 5.

Conclusion

5.93 The committee considers that the development of intermediary organisations in Australia, particularly CDFIs, is a crucial component in the development of a robust capital market for social economy organisations. The committee believes that potential exists for government to support in some form to the CDFI sector, with a particular emphasis on start-up funding and funding for ongoing operational costs and organisational development. The committee agrees with the PC report's finding that such support should not initially extend to a capital fund from which CDFIs can draw funds.

5.94 The committee notes that the current CDFI pilot program and SEDIF initiative are providing support for a small number of Australian financial intermediary organisations, and suggests that lessons learned from these programs should be used to guide further government involvement in the CDFI sector in Australia. The committee notes that the current CDFI pilot program is limited to organisations providing products and services to excluded individuals. The committee considers that, in line with the PC's recommendation, Australian governments should investigate options for providing support for CDFIs offering financial products and services to social economy organisations in Australia.

5.95 The committee notes the potential for tax incentives to be used as a means of encouraging private investment into the CDFI sector, however further work needs to be done to determine if this is appropriate in the Australian context. The committee notes that the Centre for Social Impact (CSI) is currently undertaking a study, commissioned by FaHCSIA, looking at the legislative and regulatory environment required to build a sustainable CDFI sector and the role of government in this process. This study, to be released later this year, will help inform the debate about whether or not tax incentives to support CDFIs may be useful in Australia. The committee considers that the proposed Social Finance Taskforce would be well placed to consider how the CDFI sector may be encouraged in its role of providing products and services to social economy organisations, what government support is needed and what incentives may be required to attract private investment to CDFIs.

5.96 The committee does not believe that the creation of a wholesale social investment bank through public funding is appropriate in Australia at this time. Such a wholesale bank may be appropriate in the future when the capital market for social economy organisations is more mature.

5.97 The role of intermediaries in building the capacity (both financial and non-financial) of social economy organisations is also crucial to the development of the sector and needs to be strengthened. Government can facilitate this by promoting existing initiatives, for example through the Office for the Not-for-Profit Sector website, and through providing funding to initiatives in some circumstances.

Recommendation 5.2

5.98 The committee recommends that the proposed Social Finance Task Force consider possible options to develop Community Development Financial Institutions in Australia, taking into account:

- **the findings of the forthcoming study commissioned by FaHCSIA into the current regulatory and legislative environment for Community Development Financial Institutions in Australia;**
- **whether tax incentives should be established to encourage investment in CDFIs in Australia; and**
- **any other initiatives that may benefit the development of CDFIs investing in social economy organisations.**

Recommendation 5.3

5.99 The committee recommends that Australian governments explore options to promote and strengthen intermediary organisations that provide capacity building, training and support services to social economy organisations.